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No.

IN THE

SUPREME COURT OF THE UNITED STATES

IVOR F. BENCI-WOODWARD and
DEBRA A. BENCI-WOODWARD,
LAURENTZ J. MANGUM and BARBARA MANGUM,
JOSE RAGATZ and DIANNE M. RAGATZ,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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26 pp

QUESTIONS PRESENTED

1. Whether the Internal Revenue Service should allow the apportionment of respective gross incomes of client and attorney subject to a contingency fee agreement under which the client gives up substantial control over the prosecution and recovery of his claim?

2. Whether assignment of income principles appropriately apply in a contingency fee contract between an attorney and client?

3. Whether the "Alternative Minimum Tax" was intended to apply to deductions of attorney fees in contingent fee arrangements?

PARTIES TO THE PROCEEDING

The Law Offices of Philip Garrett Panitz, P.C., represent petitioners Ivor and Debra Benci-Woodward, Laurentz and Barbara Mangum, and Jose and Diane Ragatz, and on their behalf respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

It is anticipated that the Office of the Solicitor General of the United States will represent the respondent, United States of America, real party in interest Department of the Treasury's Internal Revenue Service.

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OPINIONS BELOW

The opinion of the court of appeals (App. A, p. 1a) is reported at 219 F.3d 941. The opinion of the tax court (App. B, p. 9a) is reported at T.C. Memo. 1998-395.

JURISDICTION

The judgment of the court of appeals was entered on July 18, 2000. The jurisdiction of this Court is invoked under 26 U.S.C. 7482 and 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

1. 26 U.S.C. 61(a) provides, in relevant part:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *.

2. 26 U.S.C. 104(a) provides, in relevant part:

> * * *[G]ross income does not include- * * *
>
> (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness * * *.

3. 26 U.S.C. 67 provides, in relevant part:

> 2-percent floor on miscellaneous itemized deductions.
>
> (a) General rule. In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income.

(b) Miscellaneous itemized deductions. For purposes of this section, the term "miscellaneous itemized deductions" means the itemized deductions other than—

(1) the deduction under section 163 (relating to interest),

(2) the deduction under section 164 (relating to taxes),

(3) the deduction under section 165(a) for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d),

(4) the deductions under section 170 (relating to charitable, etc., contributions and gifts) and section 642(c) (relating to deduction for amounts paid or permanently set aside for a charitable purpose),

(5) the deduction under section 213 (relating to medical, dental, etc., expenses),

(6) any deduction allowable for impairment-related work expenses,

(7) the deduction under section 691(c) (relating to deduction for estate tax in case of income in respect of the dedecent),

(8) any deduction allowable in connection with personal property used in a short sale,

(9) the deduction under section 1341 (relating to computation of tax where taxpayer restores substantial amount held under claim of right),

(10) the deduction under section 72(b)(3) (relating to deduction where annuity payments cease before investment recovered),

(11) the deduction under section 171 (relating to deduction for amortizable bond premium), and

(12) the deduction under section 216 (relating to deductions in connection with cooperative housing corporations). * * *

4. 26 U.S.C. 55 provides, in relevant part:

(a) General Rule.

There is hereby imposed (in addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of –

(1) the tentative minimum tax for the taxable year, over

(2) the regular tax for the taxable year. * * *

5. 26 U.S.C. 56(b) provides, in relevant part:

(b) Adjustments applicable to individuals.

In determining the amount of the alternative taxable income of any taxpayer (other than a corporation), the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) Limitations on deduction.

(A) In general. No deduction shall be allowed –

(i) for any miscellaneous itemized deduction (as defined in section 67(b))* * *.

STATEMENT OF THE CASE

This case concerns the proper method for calculating the gross income of plaintiffs who receive a taxable damage award payable in part to their attorney pursuant to a contingency fee agreement entered into at the commencement of litigation. This issue has split the United States Courts of Appeals, as more fully explained below.

The case has tremendous ramifications to plaintiffs who recover any type of taxable recovery, since the effect of the decision of the United States Court of Appeals for the Ninth Circuit in the case below would result in a chilling effect on any type of taxable tort damage claim.

A. Case History.

1. Appellants Ivor Benci-Woodward, Laurentz Mangum and Jose Ragatz were all plaintiffs in a lawsuit against defendants Dayton-Hudson, Inc., and Dana Pereau. [CR 16; ER 13, p. 2][1]. For the sake of brevity, all three plaintiffs and appellants herein will be collectively referred to as "appellants." The appellants sued for false imprisonment, fraud, defamation (including libel and slander), intentional infliction of emotional distress, wrongful discharge in violation of public policy, breach of an implied-in-fact employment contract, breach of the implied covenant of good faith and fair dealing, constructive discharge, and intentional misrepresentations. [CR 16; ER 13, p. 2] Appellants' civil attorney, John Howard, litigated appellants' claims pursuant to an enforceable contingency fee agreement. [CR 25; ER 14, Exhibits 11-K, 12-L and 13-M].

As a result of the lawsuit, which went to a jury trial, appellants were awarded both compensatory and punitive damages [CR 16; ER 13, Exhibit 8-H].[2] Defendant

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[1]All references to CR and to ER are to the Court Reporter's Transcript and the Excerpts of Record as provided to the United States Court of Appeals for the Ninth Circuit.

[2]A fourth plaintiff, Paul Reyes, was involved in the lawsuit against Dayton-Hudson, but was not involved in the Tax Court litigation.

Dayton-Hudson, Inc., paid both the punitive and compensatory damages awarded against them, directly to the trust account of the appellants' attorney. [CR 16; ER 13, p. 3, Exhibit 8-H]. Defendant Dana Pereau only paid the punitive damage portion of the award as set forth in the Verdict Summary. [CR 16; ER 13, p. 3, Exhibit 8-H].

Each appellant was awarded $1,190,000 in punitive damages from Dayton-Hudson, Inc. Appellants Ragatz and Mangum were each awarded $16,000 in punitive damages from Dana Pereau, while petitioner Benci-Woodward was awarded $12,000 in punitive damages from Dana Pereau. [CR 16; ER 13, Exhibit 8-H].

When appellants received their judgment in 1992, the taxability of punitive damages under the version then in effect of 26 U.S.C. 104(a)(2) was unclear. Therefore, appellants did not include the punitive damages received in 1992 as income on their respective income tax returns. The Internal Revenue Service (the "IRS"), in a notice of deficiency issued to each appellant, determined that the punitive damage portion of the award was includable in income pursuant to 26 U.S.C. 61. Subsequent to the receipt of the damage awards, both Congress and this Court determined conclusively that punitive damages are, in fact, taxable. (See 26 U.S.C. 104(a)(2) as amended in 1996 P.L. 104-188 §1605(a); *O'Gilvie v. United States*, 519 U.S. 79 (1996).)

2. The damages awarded to each appellant were paid to attorney John Howard's trust account. The attorney fees retained by Mr. Howard as his contingency fee from the recovery due appellant Ivor Benci-Woodward totaled $751,420. The IRS determined that $670,135 of this amount were attributable to the punitive damage award. The attorney fees retained from the recovery due appel-

lant Laurentz Mangum totaled $659,766, of which the IRS determined that $626,447 was attributable to the punitive damage award. Finally, John Howard retained $634,147 as his contingent fee of appellant Jose Ragatz's recovery, of which the IRS attributed $603,390 to punitive damages. [CR 16; ER 13, pp. 4-5, Exhibits 9-I and 10-J]. The balance of each contingency fee retained by John Howard and not allocated to punitive damages was allocated to compensatory damages, and therefore was not taxable to the appellants (although the entire contingency fee, both compensatory and punitive, was taxable to John Howard as it represented his fee for services rendered).

The contingency fees retained by appellants' attorney John Howard were all reported on Mr. Howard's 1992 individual income tax return as taxable income. He reported this properly on his Schedule C as gross receipts from his law practice. [CR 16; ER 13, p. 6]. This fact was stipulated to by all parties, including the IRS, at the United States Tax Court (USTC Stipulation of Facts). The effect of Mr. Howard including the attorney fees on his Schedule C was to include the portion of the recovery paid directly to him pursuant to the contingency fee agreement in taxable income pursuant to 26 U.S.C. 61.

3. In the notices of deficiency issued to each appellant, the IRS determined that the entire punitive damage award, including that portion retained as a contingency fee by John Howard, was required to be reported as gross income on each appellants' 1992 income tax return. The IRS position concluded the appellants were required to report the entire punitive damages award in gross income

and then would be allowed a miscellaneous itemized deduction for their attorney's fees and costs as an expense incurred in the production and collection of income under 26 U.S.C. 212(1). The attorney's fees and costs were therefore to be treated as a miscellaneous itemized deduction by the IRS subject to the two percent floor provided by 26 U.S.C. 67. The IRS then proceeded to negate the deduction for the attorney's fees altogether through the application of the alternative minimum tax regime ("AMT"), codified in 26 U.S.C. 55 through 59. By subjecting the entire recovery to this interpretive path through the Internal Revenue Code, the IRS effectively gave with one hand while taking away with the other.

B. Illustration of Application of IRS Position to Damage Award.

The following is an illustration of the manner in which the IRS has proposed to tax appellants as it pertains to appellant Ivor Benci-Woodward.[3]:

IVOR BENCI-WOODWARD

Punitive Damage Award recovered (89.2% of total award)[4]

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[3]Unless otherwise noted, this illustration uses the actual numbers in the case, as set forth by the IRS in their notice of deficiency. [CR 16; ER 13, Exhibit 1-A]

[4]The IRS's adjustments to income in their notice of deficiency does not break down the punitive damages award by defendant in the civil action and only lists the combined total award of $1,202,000 in punitive damages. Therefore, the amount of the award subject to taxation, the punitive damage component, is only used in the example. The punitive damage award represents 89.2% of the entire award.

(1) Dayton-Hudson, Inc.	$1,190,000
(2) Dana Pereau	$ 12,000
Interest recovered on punitive damage award	$142,984
Total received attributable to punitive damages	$1,344,984

AMOUNTS PAID OR TO BE PAID OUT OF PUNITIVE DAMAGE AWARD: (Ivor Benci-Woodward, continued):

Attorney fees and costs retained by John Howard:	<$670,135>
Amount due the IRS per notice of deficiency for tax on punitive damage award:	<$235,993>[5]
Amount due the IRS attributable to alternative minimum tax calculation (and loss of attorney fees deduction):	<$85,009>
California Income Tax (calculated on the 8.5% alternative minimum tax rate applicable in California in 1992):	<$114,324>[6]
Totals to be paid out related to punitive damage award:	<$1,105,461>

[5]This amount is the difference from the tax shown on the return and the total tax calculated after the inclusion of the punitive damages in appellant's income for 1992, i.e., this is the amount of tax attributable to the punitive damages adjustment prior to the application of the alternative minimum tax.

[6]This amount is an estimate of the California adjustment to appellants' income tax that will occur as a result of the IRS's proposed method of taxing the punitive damages award.

Total net recovery from $1,344,984 punitive damage award: **$239,523**[7]

As the above illustrates, appellant Ivor Benci-Woodward would receive less than 18% of the total recovery awarded on his behalf by the California Superior Court jury if he is taxed in the manner advocated by the IRS. Furthermore, of the $674,849 appellant received after attorneys' fees and costs, $435,326 would be payable in federal and state taxes as a result of the IRS effectively disallowing the deduction for attorney's fees and costs through the application of the AMT. Thus, of the funds actually received by appellant Ivor Benci-Woodward from the punitive damages award, over 64% would be paid in federal and state income taxes. Simultaneously, attorney John Howard is being taxed on the full $670,135 received by him as his contingency fee interest in the Ivor Benci-Woodward award. By calculating the tax ramifications in this manner, the IRS has expanded the tax base from 100% to an amount almost equivalent to 160%. This is also known as "double taxation." The foregoing analysis applies equally to appellants Laurentz Mangum and Jose Ragatz.

4. On fully stipulated facts, the tax court granted summary judgment to the IRS. (App. B, p. 9a). The tax

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[7]It is worth noting that the AMT rate was actually lower in 1992 than it is today. If appellant Ivor Benci-Woodward were to receive the same award today, and was taxed in the manner advocated by the IRS and affirmed by the Ninth Circuit's opinion, he would actually owe an additional $57,609 in federal income taxes under the current rates, thereby reducing his already paltry net recovery even further. Effectively, the IRS is utilizing the AMT to render claims for any taxable damages award economically unviable.

court concluded that legal fees and costs were subject to inclusion in appellants' gross income. The tax court further concluded that appellants' attorney's fees and costs were a miscellaneous itemized deduction subject to the two percent floor provided by 26 U.S.C. 67 and the application of the alternative minimum tax. The tax court refused to follow *Cotnam v. Commissioner of Internal Revenue*, 263 F.3d 119 (5th Cir. 1959) (App. C, p. 22a), where it was not bound to do so by the *Golsen* rule, and held appellants' "gross income includes their punitive damages awards unreduced by their attorney's fees (and costs)." *Benci-Woodward, et al. v. Commissioner of Internal Revenue*, T.C. Memo. 1998-395. (App. B. p. 9a). See also *Golsen v. Commissioner of Internal Revenue*, 54 T.C. 742 (1970), aff'd. 445 F.2d 985 (10th Cir. 1971); *Davis v. Commissioner of Internal Revenue*, T.C. Memo. 1998-248 (Wherein the tax court applied *Cotnam* to a case appealable to the Eleventh Circuit where *Cotnam* is the controlling authority.)

5. The Ninth Circuit affirmed. (App. B, p. 9a). Following its holding in *Coady v. Commissioner*, 213 F.2d 1187 (9th Cir. 2000) (App. G, p. 87a), the court of appeals held that contingent attorney fees are income to the taxpayer and subject to the AMT. The court of appeals stated in footnote 2 of its opinion: "Petitioners' effort to distinguish contingent fees from other anticipatory assignments of income due to the uncertainty of their realization is foreclosed by *Coady*. '[T]he fact that such an assignment involves a contingent amount does not alter the conclusion that taxation cannot be escaped by making anticipatory arrangements to prevent earnings from vesting in the person who earned it.' " (App. G, p. 87a). The court of appeals further relied on *Alexander v. United States*, 72 F.3d 938 (1st

Cir. 1995), (App. H, p. 100a), for the proposition that the deduction for attorney's fees and costs is subject to disallowance through the application of the alternative minimum tax. In *Coady*, the court of appeals refused to follow the holdings of the Fifth Circuit and Sixth Circuit in *Cotnam v. Commissioner of Internal Revenue*, 263 F.3d 119, 125 (5th Cir. 1959), (App. C, p. 22a), and *Estate of Clarks v. United States*, 202 F.3d 854, 857 (6th Cir. 2000), (App. D, p. 39a), based on perceived differences in state law regarding attorney liens and the conclusion that a contingency fee agreement constituted an anticipatory assignment of income. *Coady* at 1190-1191.

REASONS FOR GRANTING THE PETITION

I.

THERE IS A SPLIT OF AUTHORITY IN THE CIRCUIT COURTS REGARDING THE TAXABILITY OF CONTINGENT FEE AWARDS.

The United States Courts of Appeals are divided regarding how to tax contingency fee awards. The United States Court of Appeals for the Ninth Circuit held in this case that the portion of a taxable damages award retained by an attorney pursuant to a binding contingency fee agreement constitutes gross income to the attorney's client. In so ruling, the court of appeals adopted the reasoning and conclusions of the Federal Circuit in *Baylin v. United States*, 43 F.3d 1451, 1454 (1995), (App. I, p. 120a), and the First Circuit in *Alexander v. United States*, 72 F.3d 938, 944 (1995), App. H, p. 100a). In contrast, the Fifth Circuit has ruled that attorney's fees payable pursuant to a contingency fee agreement are income to the attorney alone, and not incudable in the gross income of the client. *Cotnam v. Commissioner of Internal Revenue*, 263 F.3d 119, 125 (1959), (App. C, p. 22a). The Fifth

Circuit has recently reaffirmed the decision in *Cotnam*, and several other circuits have followed its holding. *E.g.*, *Srivastava v. Commissioner of Internal Revenue*, 220 F.3d 353 (5th Cir. 2000) (App. F, p. 52a); *Davis v. Commissioner of Internal Revenue*, 210 F.3d 1346, 1348 (11th Cir. 2000) (App. E, p. 47a); *Estate of Clarks v. United States*, 202 F.3d 854, 857 (6th Cir. 2000), (App. D, p. 39a). Even the United States Tax Court has wrestled with this problem, and the judges of that court are not in agreement with each other. See *Kenseth v. Commissioner of Internal Revenue*, 114 T.C. 26 (2000).[8] Judge Beghe of the United States Tax Court wrote an exceptional history of the issue in his dissent, joined by

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[8] In *Kenseth*, the tax court addressed the identical issues involved in this case in great detail in a contentious split decision. The majority ruled in favor of the IRS, while a substantial minority questioned the application of the assignment of income doctrine to contingency fee agreements. The tax court held that the taxpayer was required to include the entire amount of his award in gross income undiminished by the amount withheld by his attorneys pursuant to his binding contingency fee agreement. The dissenting opinion, written by Judge Beghe, noted the egregious tax consequences resulting from the intersection of judge-made assignment of income principles with the alternative minimum tax provisions as applied by the majority. The dissent pointed out: "The majority in the instant case tax to petitioners substantial funds that petitioners did not receive, were never entitled to receive, and never turned their backs on. They do so in the name of the assignment of income doctrine . . . But when experience and analysis show that we have departed from the origins that we once thought to be the foundations of those decisions, and when it is our judicial interpretations and not the statute law that lead to results that increasingly seem unjust, then we ought to reexamine the foundations of the doctrine."

Judges Parr, Wells, Colvin, and Renato. Judge Chabot wrote a separate dissent.

This issue applies to every litigant who receives a taxable damages award. Absent a resolution of the clear conflict among the circuits on this recurring question, the tax treatment of attorney's fees retained pursuant to a contingency fee agreement will vary solely due to geographical happenstance. For the reasons we will describe, the analysis adopted by the court of appeals in this case misapplies the assignment of income doctrine resulting in the taxation of the same income to both the attorney and client.

II.
THE ASSIGNMENT OF INCOME DOCTRINE SHOULD NOT BE APPLIED TO CONTINGENCY FEE CASES.

This case requires a determination of whether or not attorney's fees retained pursuant to a contingency fee agreement from a taxable judgment constitute gross income to both the attorney and the attorney's clients. The IRS insists this is the proper method of reporting a damage award subject to a contingency fee. The Fifth Circuit was the first circuit to directly address this issue in *Cotnam v. Commissioner of Internal Revenue,* 263 F.3d 119 (1959), (App. C, p. 22a). In *Cotnam,* the Fifth Circuit acknowledged that the taxpayer assigned 40% of her claim in order to be afforded the opportunity to collect the remaining sixty percent, but recognized this was not an assignment of income within the parameters of *Lucas v. Earl,* 281 U.S. 111, 50 S.Ct. 241 (1930). *Cotnam* at 125, (App. C, p. 22a).

In *Lucas v. Earl,* a taxpayer entered into a contract with his wife assigning her 50% of his income. This Court

held the taxpayer's entire income was taxable to him. The decision in *Lucas v. Earl* was necessary to protect the integrity of our graduated income tax system by taxing the party responsible for procuring the income. The common denominator in all assignment of income cases is that the taxpayer attempts to avoid the adverse tax effects of our graduated rate system by assigning income attributable to the assignor taxpayer to a related taxpayer in a lower tax bracket or to a creditor to escape taxation altogether. This can be accomplished by an anticipatory assignment of rights to income to relatives in lower tax brackets, such as in *Lucas v. Earl, supra,* or *Helvering v. Horst,* 311 U.S. 112, 61 S.Ct. 144 (1940), or by assigning income to creditors prior to receiving the income. In both cases tax avoidance is the objective. This Court has appropriately rejected all such schemes.

However, the facts of *Cotnam,* and all cases involving taxable damage awards, are fundamentally different from what is traditionally considered an assignment of income. In *Cotnam,* the taxpayer assigned 40% of what would otherwise be a worthless claim. The Fifth Circuit stated: "At the time she (the taxpayer in *Cotnam*) entered into the contingent fee contract, she had realized no income from the claim, and the only use she could make of it was to transfer a part so that she might have some hope of ultimately enjoying the remainder." *Cotnam* at 125 (See App. C, p. 22a). When the taxpayer in *Cotnam* assigned a portion of her claim to her attorney the claims had no recognizable or realizable value. Rather than attempting to escape tax consequences by assigning income, the taxpayer realized the necessity of assigning a portion of her claim to enable her to potentially recover the remainder. The Fifth Circuit realized the doctrine in *Helvering v. Horst,* holding a taxpayer taxable

on the full economic gain represented by his right to receive income "can have no just or realistic application to a case like this, where the only economic benefit to the taxpayer was as an aid to the collection of a part of an otherwise worthless claim." (App. C, p. 22a) *Cotnam* at 126.

The Fifth, Sixth, and Eleventh Cicruits have thus correctly chosen to follow the common sense rule set forth in *Cotnam* that attorney fees are taxable in full, one time, allocated to both the attorney and client consistent with the split of the taxable award pursuant to their contingency fee agreement.

In contrast, the Ninth Circuit in this case and the Federal Circuit in *Baylin v. United States,* 43 F.3d at 1454, incorrectly concluded that attorney's fees retained pursuant to a contingency fee agreement were taxable to the client under assignment of income principles. These courts seemingly applied assignment of income principles in a mechanical way that failed to consider the underlying realities of the transaction. Clients do not enter into contingency fee agreements to avoid taxation through a cleverly devised anticipatory assignment of income. Rather, economic reality compels clients to enter into contingency fee agreements so that they may be afforded the opportunity to enforce their rights. By ignoring the fact that a contingency fee agreement effectively splits the interests in a claim between an attorney and client, the First, Ninth and Federal Circuits have failed to heed this Court's wise observation in *Helvering v. Horst* that "[c]ommon understanding and experience are the touchstones for the interpretation of the revenue laws." *Id.* at 118.

III.

THE STATE LIEN LAW ANALYSIS ADOPTED BY THE NINTH CIRCUIT, THE FIRST CIRCUIT, AND THE FEDERAL CIRCUIT, IS INAPPOSITE TO THE TAXATION OF CONTINGENT ATTORNEY FEE AWARDS.

The United States Court of Appeals for the Ninth Circuit in this case attempted to distinguish California attorney lien law from that of Michigan law (applicable in *Estate of Clarks*) and Alabama attorney lien law (applicable in *Cotnam*) as a basis to conclude that the full damage recovery of appellants was required to be included in income without offset of the portion of the damage award retained by their attorney. However, the Fifth Circuit in *Srivastava v. Commissioner of Internal Revenue*, 220 F.3d 353, 363-364 (5th Cir. 2000), (App. F, p. 52a), properly rejected the state by state approach to determining the proper tax treatment of contingent attorney's fees. The Fifth Circuit correctly observed:

> "The Commissioner invites us to distinguish *Cotnam* on the ground that we are faced with contingent fees governed by the law of Texas, not Alabama. The distinction rests on the predicate that Alabama gives its contingent fee attorneys a greater degree of power to enforce their rights than does Texas. These distinctions, however, should not affect the analysis required by the anticipatory assignment of income doctrine, which looks to the taxpayer's degree of control and dominion over the asset."

The vagaries of the attorney lien law of each state should not dictate the proper federal tax treatment of damage awards subject to a contingency fee agreement. Otherwise, each state could enact attorney lien legislation that directly affects the federal taxation of taxable damage awards.

IV.

DAMAGE CLAIMS WOULD BE IMPRACTICAL TO PURSUE IF THE NINTH CIRCUIT OPINION STANDS.

The Ninth Circuit and other jurisdictions holding contingent attorney fees includable in a client's gross income, have rendered many, if not all, taxable damage awards economically unviable to pursue. A client who in the best case will receive approximately twenty percent of an award, and who in the worst case could actually owe money to pay attorney's fees, costs, and taxes even when awarded a substantial sum of money, will be dissuaded from even attempting to vindicate his or her rights. As a result, the capacity to enforce federally protected civil rights would in large part depend on whether or not the taxpayer lives in a circuit which includes contingent attorney fees in a client's gross income. The difference in the tax consequences resulting from the split in the circuits on the issues involved in this case is not a matter of degree, but actually dictates whether or not a claim is financially viable to pursue in the first place. Similarly situated residents of the Fifth, Sixth and Eleventh Circuits will be able to pursue claims that are financially foreclosed to residents of the First, Ninth and Federal Circuits[9]. The questions presented in this case are of substantial recurring importance as they affect every plaintiff suing for damages unrelated to physical injury or physical sickness, including all civil rights, discrimination, and wrongful termination claims. In the absence

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[9]See the illustration of the tax effect on appellant Benci-Woodward's recovery in the Statement of the Case under the Ninth Circuit, First Circuit and Federal Circuit's line of reasoning.

of a decision from this Court, the tax treatment of taxable damages awards will vary solely based on the circuit in which the taxpayer happens to reside. The substantial differences in tax treatment between the circuits may render a citizens' rights enforceable in one jurisdiction, but economically unfeasible to pursue in another jurisdiction. Review by this Court is needed to avoid continuing uncertainty and inconsistent application of the revenue laws.

V.
ALTERNATIVE MINIMUM TAX WAS NEVER MEANT TO BE APPLIED TO THE TAXATION OF CONTINGENT FEE AWARDS.

Furthermore, the AMT was never intended to be applied in the manner it has been in this case. The IRS relies as authority on 26 U.S.C. 56(b) for computing alternative minimum tax without allowing the attorney fees deduction. Section 56(b) determines "adjustments" applicable to individuals:

> "In determining the amount of the alternative minimum taxable income of any taxpayer (other than a corporation), the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax): (1) Limitation on deductions. (A) In general. No deduction shall be allowed – (i) for any miscellaneous itemized deduction (as defined in section 67(b))." 26 U.S.C. 56(b)(1)(A)(i).

Since 26 U.S.C. 67(b) specifically defines those deductions which do not fall into the residual category of "miscellaneous" itemized deductions, and attorney fees paid on punitive damage awards are not one of the chosen few excised from the residual category, the IRS argues that attorney fees are therefore by default a mis-

cellaneous itemized deduction pursuant to section 67(b), and not permitted as a deduction to be considered when computing the alternative minimum tax under section 56(b)(1)(A)(i). While attorney fees are omitted from the enunciated categories of deductions discussed in section 67(b), appellants believe that this does not indicate Congress' intent to omit this category of deductions.

Since punitive damage awards were not definitively determined to be taxable until recently, there was no prior need for a determination that attorney fees should be allowed as an itemized deduction excluded from the miscellaneous itemized deduction "catch-all" of section 67(b). Prior to the modifications to 26 U.S.C. 104(a)(2) and the decision of this Court in *O'Gilvie v. United States*, 519 U.S. 79 (1996), attorney fees would not have been allowed as a deduction at all since the punitive damage recovery was not included in income. Now that it has been determined conclusively that punitive damages are taxable, the manner of taxing those damages advocated by the IRS results in the unconscionable situation of the same portion of a single recovery being taxed to both the attorney and client.

This was not the intent of the legislature in enacting the alternative minimum tax. As stated in Senate Report No. 313, 99th Congress, the purpose of the alternative minimum tax was to "ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions and credits." The purpose would be distorted in the opposite direction if the alternative minimum tax were used to create a tax on the same income twice, or to tax the appellants on money that they literally never received (since the money was deposited into their attorney's trust account and

they received only the net after the legal fees and costs were deducted).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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